RESERVE BANK OF FIJI

ECONOMIC REVIEW

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OVERVIEW

The global economy remains on track for positive growth this year despite the slowdown in the US economy during the first quarter. In addition to the US, lower growth rates are expected for Japan and the Euro-zone while the economies of our closest trading partner countries, Australia and New Zealand are expected to improve in 2007.

Domestically, growth for 2006 is now estimated at 3.4 percent, slightly lower than the 3.6 percent envisaged earlier.

For 2007, the economy is now expected to contract by 2.5 percent. The decline in GDP reflects reduction in tourist arrivals, the contracting building & construction sector and an anticipated reduction in Government's operating expenditure. The absence of gold production at Vatukoula is also contributing to the expected contraction in 2007.

In line with the declining economy, employment conditions have remained soft in the last few months with increasing spare capacity noted in the tourism, mining and manufacturing sectors. The latest Fiji Employers' Federation (FEF) Employment Disruptions Survey[1] showed more full time workers were made redundant between the January and February survey.

The annual rate of credit growth is declining from its peak in May 2006. Monthly data confirm this trend as on average, lending has grown just 0.3 percent in the post credit ceiling period[2] compared to an average monthly growth rate of 1.8 percent in the year leading to the credit ceiling imposition. New loans have also fallen significantly. The value of loans for consumption purposes shows a decline in recent months but outstanding investment loans continue to rise mainly due to special approvals granted by the Reserve Bank. Although it is the Bank's desire to curb credit, exceptions are made for special investment projects in the interest of the country.

Imports continue to grow strongly. Although the slower pace of credit growth is expected to dampen import demand, it may take some time before its full effects are realised. Merchandise import payments rose by around 13.8 percent in 2006, or 7.1 percent excluding mineral fuels. Mineral fuel imports were $238 million higher than in 2005. Although lower than last year, the 2007 forecast growth in import payments is still expected to be strong at 5.7 percent, largely underpinned by payments for machinery & transport equipment (mainly investment items) and mineral fuels[3]. While fuel prices have fallen from a peak in August 2006 of US$78 per barrel to current levels of around US$60, price pressures are not expected to abate significantly.

At the same time, exports performance remain dismal. Last year, export earnings grew marginally by 0.8 percent, after a 1.1 percent decline in 2005. Excluding re-exports (mainly mineral fuels), the outcome was worse with export receipts falling by 1.6 percent. For 2007, exports are projected to fall by 3.4 percent.

Higher profit remittance and migrant transfer outflows, and falling surplus in the services account are adding to the pressures on Fiji's balance of

[1] The FEF has been conducting monthly Employment Disruptions Surveys since the political upheaval on 5 December 2006. The survey aims to gauge employment conditions in FEF's member companies.

[2] Post ceiling period (Dec 2006 – Feb 2007), refers to the period after the credit ceiling on commercial banks was imposed.

[3] Fuel and investment related imports account for around 50 percent of total imports.

payments.

As at the end of February, official foreign reserves were at $802.2 million (provisional), equivalent to 3.3 months of imports of goods.

SECTORAL DEVELOPMENTS

The finance, insurance, real estate & business services; agriculture, forestry, fishing & subsistence; manufacturing and electricity & water sectors are forecast to register positive outcomes in 2007. However, these will not be sufficient to offset the contractions projected for most sectors of the economy in 2007.

Economic growth for 2008 has been revised down to 2.0 percent from 2.2 percent. Weaker growth is now expected for the agriculture, forestry, fishing & subsistence; manufacturing and electricity & water sectors. However, the finance, real estate & business services; wholesale & retail trade and hotels & restaurants and transport & communication sectors are anticipated to lead growth in 2008. In contrast, contractions are expected from the community, social & personal services; building & construction and mining & quarrying sectors.

Copra

The latest statistics from the Coconut Industry Development Authority show that in 2006, copra production amounted to around 11,148 tonnes, representing a decline of around 1.3 percent on an annual basis. The minimum mill gate price of copra remained unchanged at $500 per tonne, in the review period. Government's subsidy to the mill gate price was $48.42 per tonne.

Electricity

Electricity production continues to rise. Cumulative to February, total electricity generated by the Fiji Electricity Authority was around 129,204 megawatt hours, an increase of 1.9 percent over the corresponding 2006 level.

Labour Market

Employment conditions remained soft with increasing spare capacity noted in the tourism, mining and manufacturing sectors. The latest FEF Employment Disruptions Survey showed that more full time workers were made redundant between the January and February survey.

Cumulative to February, around 3,800 individuals were registered as new taxpayers with the Fiji Islands Revenue and Customs Authority, representing an annualised increase of around 45.0 percent, partly due to replacement workers for migrant outflows. The highest number of new taxpayers were registered in the community, social & personal services sector followed by the wholesale, retail trade and restaurants & hotels; finance, insurance, real estate & business services; manufacturing; transport, storage & communications and building & construction sectors.

With respect to wages, the civil service had a 5.0 percent reduction in remuneration across the board this year.

Inflation

Inflation in February was 3.6 percent compared with 2.6 percent in January. Over the month, consumer prices rose by 1.3 percent due to higher costs of food, services, clothing & footwear and miscellaneous items. Higher costs of imported wheat used for bakery products, resulted in the increase in food items. In addition, prices of market products were also higher following the recent flash floods. Charges for services also rose due to increases in the cost of entertainment, other educational charges and medical fees. Moreover, the flow-on effects of import and excise duties announced in November last year are gradually being reflected in the prices of clothing & footwear and miscellaneous items. On the other hand, costs of durable household goods, heating & lighting and transport fell while the prices of alcoholic drinks & tobacco and housing remained unchanged.

The underlying measure of inflation, the trimmed mean, rose to 2.2 percent compared to 2.0 percent recorded in January. Core prices have been registering an upward trend since August last year, largely a result of higher house rentals, certain market items and due to the electricity fuel-surcharge. While the gradual rise in core inflation is notable, it is still at a level that is considered low and well contained.

In the coming months, certain domestic and external factors are likely to raise inflationary pressures. On the domestic front, prices of primary produce are expected to mount, especially in flood stricken areas as it may take time for the supply of market items to be restored. In line with this expectation, prices of market items showed a significant increase in March, raising the inflation rate to higher-than-expected levels. Furthermore, various changes in fiscal and excise duties on various luxury items, white goods, certain food items and other goods that became effective via the revised Budget announcement in early March are expected to add a net 0.13 percentage points to the March Consumer Price Index. On the external arena, global oil prices have been trending upwards and are anticipated to remain high in the approaching months.

Although demand is expected to dampen this year due to the forecast economic contraction and the reduction in civil servant salaries, these effects usually take time to feed into business and household decisions, but are expected to be reflected in prices in the medium term. Hence, it is expected that the immediate impact from the Budget will come from the changes in fiscal and import excise duties. As such, the 2007 year-end inflation is now projected at 3.5 percent.

Monetary and Financial Developments

- **Lending**

Latest data show that the pace of annual credit growth continues to come down. In the year to February, total commercial banks' credit rose by 18.6 percent compared with a growth of 20.0 percent in the previous month. The growth was underpinned by higher credit disbursements to the building & construction, manufacturing, and the wholesale & retail trade and real estate sectors and to private individuals (mainly for housing purposes).

Furthermore, following the imposition of the credit ceiling, the growth in total commercial bank lending on a monthly basis continue to fall in the post ceiling period. During this period, the monthly growth of total commercial banks' loans averaged just 0.3 percent, compared with 1.8 percent average growth during Nov-05 to Nov-06. At the end of February, total loans rose by 0.5 percent over the previous month. Looking ahead, the credit ceiling will help moderate credit growth further.

Growth in consumption loans disbursed by commercial banks has generally slowed. In the year to February, loans outstanding for consumption purposes rose by 13.9 percent, slightly lower than the previous month's growth. This growth was largely due to higher lending to private individuals and the duty & trade and hotels & restaurants sub-sectors of the wholesale & retail trade sector. Outstanding investment lending of commercial banks rose by 31.8 percent over the year to $426.4 million, driven by increased lending to both the building & construction and the real estate sectors. The growth rate on investment has come down from a peak growth of 65.1 percent in January 2006. On a monthly basis, commercial banks' lending towards investment grew by only 0.4 percent in February.

The annual growth rate of lending by Licensed Credit Institutions (LCIs) fell from the March 2006 peak of 23.1 percent to 9.7 percent in February this year. The growth recorded, however, was underpinned by higher lending to the real estate, transport & storage and building & construction sectors and private individuals.

- **Deposits**

Total commercial bank deposits rose by an annual 14.3 percent in February 2007 to around $2.8 billion, following a growth of 18.1 percent in January. Of total deposits in February, time deposits accounted for 47.1 percent, demand deposits 31.4 percent and savings deposits 21.5 percent. On a monthly basis, total commercial bank deposits fell by 1.7 percent.

- **Interest Rates**

In February, deposit rates largely fell while lending rates continued to rise. Commercial banks' time deposit rates fell over the month by 14 basis points and the savings deposit rate increased by 2 basis points to 0.89 percent. The commercial bank lending rate rose over the month by 106 basis points to 9.34 percent. Interest rates on new time deposits fell by 17 basis points to 9.20 percent, while the interest rate on new loans by commercial banks increased by 171 basis points to 11.82 percent.

LCIs showed similar trends. In February, the interest rate on new deposits fell to 10.77 percent from 10.86 percent in January.

- **Liquidity**

Total Bank Demand Deposit (BDD) fell to around $73 million in February from around $107 million at the end of last year. BDD was around $87 million as at 30 March this year.

Liquidity in the system tightened in the middle of last year after the Bank raised its Statutory Reserve Deposits ratio. However, liquidity eased towards the end of last year largely due to inflows of foreign reserves and injection of liquidity by the RBF. With ample liquidity during this period, interest rates offered on commercial bank deposits declined further in February compared to December 2006.

External sector

Exports performance remains dismal. Last year, export earnings grew only marginally by 0.8 percent, after a 1.1 percent decline in 2005. Higher inflows from re-exports, mineral water, fish, molasses, fruits & vegetables, yaqona and other exports underpinned this marginal growth. Garment, gold, sugar, timber and coconut oil export earnings however fell during this period. Excluding re-exports, the outcome was worse with export earnings falling by 1.6 percent. For 2007, exports earnings (excluding aircraft) are expected to remain weak. Garments, molasses and textiles are expected to post declines while gold production has ceased. These are anticipated to more-than-offset the positive inflows expected from mineral water, re-exports, fish, sugar and coconut oil. The 2007 revised budget has emphasised raising export earnings, via several measures. These are expected to result in higher foreign exchange inflows but in the medium term.

Imports on the other hand, continue to grow strongly. Merchandise import payments rose by around 13.8 percent last year or 7.1 percent excluding mineral fuels. The increase was led by higher payments for mineral fuels, machinery & transport equipments, food and chemicals, which more-than-offset declines in payments for miscellaneous manufactured goods and oils & fats. For 2007, imports growth is projected at 5.7 percent as imports of machinery & transport equipment and mineral fuels are expected to pick up further. The 2007 revised budget has increased fiscal duties on a number of luxury items and white goods. The higher fiscal rate will filter through to the price of these items, and is expected to dampen consumer demand and imports. This, however, also depends on the income availability of consumers.

Exchange Rate Developments

On the domestic front, movements in exchange rates reveal that in February 2007, the Fiji dollar strengthened against the US dollar (1.4%) but weakened against the Yen (1.8%), Euro (0.8 %), and the Australian (0.6%) and New Zealand (0.1%) dollars.

The Nominal Effective Exchange Rate Index of the Fiji dollar rose by 0.3 percent in the year to February, indicating an appreciation of the Fiji dollar against the basket of currencies.

The Real Effective Exchange Rate (REER) Index of the Fiji dollar, a gauge of our international competitiveness, rose by 1.4 percent during the review period. The increase in the REER Index over the year reflects a deterioration in our international competitiveness and was largely due to higher domestic inflation outcomes. Domestic inflation was 3.6 percent in February 2007, while average trading partner inflation was around 2.6 percent during the same period.

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FIJI: FINANCIAL STATISTICS

KEY INDICATORS	Feb-07	Jan-07	Dec-06	Feb-06
1. Money and Credit				
(year-on-year % change)				
Narrow Money	n.a	n.a	n.a.	18.42
Currency in Circulation (monthly average)	6.72	6.33	5.70	10.22
Quasi-Money (Time & Saving Deposits)	n.a	n.a	n.a.	17.58
Domestic Credit	n.a	n.a	n.a.	26.75
2. Consumer Prices 1/				
(year-on-year % change)				
All Items	3.6	2.6	3.1	2.2
Food	5.9	2.7	3.3	3.0
3. Reserves				
(end of period)				
Gross Foreign Reserves ($m)*	802.2 (p)	847.8 (p)	879.8 (p)	853.4
Months of Imports (goods)	3.3 (p)	3.5 (p)	3.7 (p)	3.6
4. Liquidity				
(end of period)				
Liquid Assets Margin to Deposit Ratio (%)	5.20	6.3	6.2	8.8
Banks' Demand Deposits ($m)	72.7	104.7	107.3	121.2
5. Interest Rates (% p.a.)				
(monthly average)				
Lending Rate (Excluding Staff)	9.34	8.28	7.89	6.63
Savings Deposit Rate	0.89	0.87	0.84	0.47
Time Deposit Rate	8.80	8.94	9.05	2.80
91-day RBF Note Rate (month end)	n.i	n.i	n.i.	2.25
Minimum Lending Rate (MLR) (month end)	5.25	5.25	5.25	3.75
Overnight Inter-bank Rate	n.t	5.25	5.28	n.t
5-Year Government Bond Yield	n.i	n.i	n.i.	4.00
10-Year Government Bond Yield	n.i	n.i	10.75	6.73
6. Exchange Rates 2/				
(mid rates, F$1 equals)				
(end of period)				
US dollar	0.6001	0.5920	0.6009	0.5708
Pound sterling	0.3058	0.3017	0.3062	0.3281
Australian dollar	0.7614	0.7663	0.7605	0.7743
New Zealand dollar	0.8590	0.8595	0.8521	0.8654
Swiss francs	0.7301	0.7413	0.7344	0.7547
Euro	0.4530	0.4566	0.4570	0.4816
Japanese yen	70.70	72.00	71.45	66.32
7. Commodity Prices (US$)				
(monthly average)				
UK Gold Price/fine ounce 2/	664.07	630.36	630.19	555.63
New York #11 Spot Market Price 3/	11.65	11.88	12.47	16.10
Crude Oil/barrel 4/	57.76	54.30	62.31	59.92

n.a. - Not available/No activity
n.i. - No issues
n.t. - No trading
** Official reserves includes foreign reserves holdings of the RBF and Non-Bank Financial Institution, as per the new definition of official reserves*

Sources:
1/ *Fiji Islands Bureau of Statistics*
2/ *Bloomberg and Reserve Bank of Fiji*
3/ *Fiji Sugar Marketing Company Limited*
4/ *Bloomberg*